The Capital Stock and the Corporate Franchise Tax Versus The Constitution in Pennsylvania

The Pennsylvania tax law is well shuffled. As is common to all tax legislation, the Pennsylvania system is sicklied o'er with the requirements of the federal and state constitutions which often conflict with the demands of political expediency and necessity for revenue. As a matter of state policy it is desirable to encourage the organization of business enterprises in Pennsylvania and induce foreign corporations to do business in the state. At the same time there is the temptation to favor local business over foreign. And, overshadowing other considerations, is the need of revenue. As a matter of law, it is simple enough to draft a constitutional tax. But to combine constitutionality with maximum revenue and satisfaction of pressure group programs (inevitably seeking favored treatment for themselves) requires a skilled hand. From the point of view of the Commonwealth, the discrimination must lurk beneath the surface of the act and be not so great as to attract the keen eye of the judiciary or, if it be ferreted out, it must be such minor inequality as is deemed inevitable in every tax system.[1]

The important question now in Pennsylvania is whether the Corporate Franchise Tax,[2] in its effort to tap the resources of foreign corporations, has exceeded the limitations of constitutionality. This matter has not, as yet, been definitely settled by the Supreme Court.[3]

The Pennsylvania system of taxing corporations, prior to the 1935 and 1937 amendments, included the capital stock tax[4] as its cornerstone. This tax applied equally to foreign and domestic corporations. Its incidence was on "each dollar of the actual value of (the corporation's) whole capital stock", at a rate of five mills. In order to reach a base on which to apply this rate, the legislature provided a means of evaluating the capital stock. Each year the officers of the corporation were to report a capital stock value which was to be ". . . (3) not less than the actual value indicated or measured by consideration of the intrinsic value of its tangible property and assets, and of the value of its good will and franchises and privileges, as indicated by the material results of their exercise taking also into consideration the amount of its indebtedness".[5]

For years, the nature of this tax and the question of what items of value could be included in computing the value of the capital stock were subjects of constant litigation. At an early date it was decided that this tax was not imposed on the privilege of being a corporation or for the

1. "Taxation is a practical and not a scientific problem." Philadelphia & Reading Coal and Iron Co. v. Northumberland County Comm'rs, 229 Pa. 460, 471, 79 Atl. 109, 112 (1911). See also Commonwealth v. Pennsylvania R. R., 297 Pa. 308, 317, 147 Atl. 242, 244 (1929); Commonwealth v. Eastern Securities Co., 309 Pa. 44, 48, 163 Atl. 157, 158 (1932).

2. PA. STAT. ANN. (Purdon, Supp. 1939) tit. 72, §§ 1871-1902.

3. Commonwealth v. Columbia Gas and Elec. Co., 336 Pa. 209, 8 A. (2d) 404 (1939), 88 U. OF PA. L. REV. 232, decided that the allocation factors in the present law were constitutional but expressly refused to pass on the question of unconstitutional discrimination. The trial court held that the necessary result of the statute was to discriminate against foreign corporations and was consequently unconstitutional.

4. PA. STAT. ANN. (Purdon, Supp. 1939) tit. 72, §§ 1871-1902.

5. PA. STAT. ANN. (Purdon, Supp. 1939) tit. 72, § 1902.

privilege of functioning as a corporation in the state. It was rather a "property tax".[6] This initial determination, however, resulted in raising numerous knotty constitutional problems and difficult matters of statutory construction. If it were a "property tax, on what specific property was the levy imposed? To answer that the "capital stock" is taxed seems to be unsatisfactory because the term "capital stock" in the hands of the corporation has no significance apart from the individual items, which, in their aggregate, are represented by the term. The tax on the capital stock, then, is a tax either on the collective assets of the corporation or on their "value". Since it is difficult to ascribe the term "property" to "value", we are forced to the conclusion that the tax is on all the assets of the corporation—the value of the business—which is a synonym for "capital stock".[7]

The statute states that the tax is to be imposed on "its *whole* capital stock".[8] This would seem to imply that the value of all assets, wherever situated, was to be taxed. But the Federal Constitution forbids the taxation of property or values where there is no jurisdiction over the subject taxed.[9] Consequently Pennsylvania can only tax the value of the business—that proportion of all its assets—which is within the state, either physically, in the case of tangible property, or according to legal fictions in the case of intangible property. Consequently the word "whole" in the statute had to be construed to mean all of the capital stock within the jurisdiction of the state or the statute had to be invalidated as an unconstitutional attempt to tax extra-state values. The former solution was adopted.[10] This necessarily meant that deductions had to be made in calculating the "whole" value of the capital stock for taxing purposes.

The first obvious deduction was the value of tangible property outside the state. This applied to all corporations owning such property. Secondly, a deduction had to be allowed foreign corporations for the total value of intangible property held by them.[11] This was on the well-established theory that intangibles have their tax situs at the domicle of their owner. A corporation's domicile is the state of incorporation, hence a foreign corporation's intangible property has its tax situs elsewhere. Since it is located elsewhere it is outside Pennsylvania's jurisdiction and, under the Constitution, non-taxable. It is true that the exclusive application of the doctrine outlined above, has been destroyed by the birth of the "commercial domicile" [12] and "business situs" [13] principles. But the legislature did not, in terms, provide for the taxation of intangibles held by foreign corporations by either of these theories and the courts have consistently refused to read them into the statute.[14]

The third necessary deduction is the value of United States bonds held by the corporation.[15] In this case, also, the deduction must be made

6. Delaware, L. & W. R. R. v. Pennsylvania, 198 U. S. 341 (1905); Commonwealth v. Standard Oil Co., 101 Pa. 119 (1882); Commonwealth v. Union Shipbuilding Co., 271 Pa. 403, 114 Atl. 257 (1921); Commonwealth v. Westinghouse Air Brake Co., 18 Dauph. 174 (1915).

7. Commonwealth v. Union Shipbuilding Co., 271 Pa. 403, 114 Atl. 257 (1921).

8. PA. STAT. ANN. (Purdon, Supp. 1939) tit. 72, § 1871.

9. Union Refrigerator Transit Co. v. Kentucky, 199 U. S. 194 (1905), "interpreting" the due process clause of the 14th Amendment of the Federal Constitution.

10. Commonwealth v. Standard Oil Co., 101 Pa. 119 (1882).

11. Commonwealth v. Curtis Publishing Co., 237 Pa. 333, 85 Atl. 360 (1912).

12. Wheeling Steel Corp. v. Fox, 298 U. S. 193 (1936).

13. Bristol v. Washington County, 177 U. S. 133 (1900).

14. Commonwealth v. Curtis Publishing Co., 237 Pa. 333, 336, 85 Atl. 360, 361 (1912). See discussion in Commonwealth v. Columbia Gas and Elec. Co., 336 Pa. 206, 8 A. (2d) 404 (1939).

15. Commonwealth v. Provident Life & Trust Co., 3 Dauph. 130 (1900).

because the Federal Constitution forbids a direct levy on the item in question.[16] While Pennsylvania may have "jurisdiction" over these bonds in the sense that they are within the boundaries of the state, it lacks the power and hence the jurisdiction to *tax* them.

In addition to these necessary deductions, certain other exemptions were allowed either by legislative lenience or by judicial construction of the statute. The first of these is the exemption of the value of stock held by the taxed corporation in a Pennsylvania corporation which was itself already subject to the capital stock tax.[17] This is a purely judicial limitation of the scope of the capital stock tax.[18] The reason for the exemption can be found simply in the well-recognized policy and presumption against double taxation. Since the held stock is already taxable to the issuing corporation and since the capital stock tax is merely a tax on the assets including, of course, the held stock, such stock must be exempt because it is presumed that there is no intention to levy two taxes on the same subject unless clearly provided otherwise by the legislature. It is not entirely clear that failure to allow the exemption would result in double taxation in the strict sense of that term, although it undoubtedly would result in a double burden on the same values. As pointed out above, the tax is levied on the assets of the corporation. Would a tax on the shares of stock in the hands of the stockholder also be a tax on the assets of the corporation? The answer is apparently in the affirmative for the purpose of determining this exemption. Nevertheless, when it was claimed that an exemption should be allowed for the value of stock held in another corporation which stock represented property outside the state, on the grounds that taxation of the stock was taxation of the foreign property, the contention was not allowed.[19] In other words, for this latter purpose, the capital stock in the hands of the stockholder is not the same subject for taxing purposes as the property which that stock represents.

The same general problem arose in connection with the evaluation of the capital stock of a corporation whose chief asset was real estate in Pennsylvania. The taxpayer claimed that the value of the real estate should be deducted in the computation of the theory, repeatedly announced by the courts, that the tax on the capital stock was a tax on the assets of the corporation and since a state statute exempted real estate from state taxation, inclusion of the real estate in the capital stock tax would be violative of the statute. Analogy to those cases exempting the value of tangible property outside the state would seem to require a holding for the taxpayer. But the court pointed out that the tax was "on the capital stock divided into shares, which is personal property", and that ". . . the capital stock is not real estate, nor is the tax on capital stock a tax on real estate".[20]

16. Weston v. Charleston, 2 Pet. 448 (U. S. 1829). There seems to be some question as to whether the recent case of Graves v. New York *ex rel.* O'Keefe, 306 U. S. 466 (1939), which threw the doctrine of intergovernmental immunity into the discard as far as the salaries of government officials is concerned, has application to United States government bonds. See Lowndes, *The Tax Decisions of the Supreme Court, 1938 Term* (1939) 88 U. of Pa. L. Rev. 1, 5. For the purposes of this discussion the old immunity is considered as law.

17. Commonwealth v. Fall Brook Coal Co., 156 Pa. 488, 26 Atl. 1071 (1893); Commonwealth v. Shenango Furnace Co., 268 Pa. 283, 110 Atl. 721 (1920).

18. In the *Fall Brook* case, *supra* note 17, the court said that since such capital stock was by statute exempted from a personal property tax in the hands of the stockholder, it was therefore exempt from inclusion in calculating a capital stock tax against a corporate holder. This seems to be a *non sequitur*.

19. Commonwealth v. Shenango Furnace Co., 268 Pa. 283, 110 Atl. 721 (1920).

20. Commonwealth v. Mammoth Vein Coal & Iron Co., 3 Dauph. 220 (1900); Commonwealth v. Schwarzchild & Sulzberger Co., 12 Dauph. 159 (1909).

Consequently it is seen that the subject of the tax changes with the purpose for which that subject is to be determined. Those cases which exempt assets over which Pennsylvania has no jurisdiction to tax stem from a United States Supreme Court decision holding that taxation of capital stock representing non-taxable property is, in effect, taxation of that property.[21] Those cases dealing with double taxation or violation of the statute exempting real estate were deciding what assets the legislature intended to reach. The reasoning is indeed inconsistent but the results seem fair.

One more exemption must be noted here. Where any domestic corporation owns a majority of the voting stock of another corporation, so much of the value of all the stock in the other corporation is exempt as represents property having a legal situs outside the state.[22] This exemption is, by its terms, accorded only to domestic corporations and was granted to ameliorate the harshness of the statute on those companies which preferred to hold foreign property through subsidiary corporations rather than directly.[23]

Before discussing the manner in which these exemptions were deducted, it is well to note here that, except for the statutory exemption, the prevailing consideration in favor of allowing the deductions was that the tax was a property tax. From that fact it followed that the exemptions should be granted.

Admitting, then, that the above exemptions should be granted, the method of their deduction was also the subject of litigation. The statute, as first drafted, provided for no exemptions—hence it provided no method of deducting them. It did, however, provide that the value of the capital stock should be calculated by considering both the assets and the indebtedness.[24] Accordingly the actual value of the capital stock would be less than the sum of the intrinsic value of its assets. If, then, the actual value of the capital stock were first computed and then the intrinsic value of the exempt items were deducted from this figure or if they were left out of the calculation altogether, the result would be that the exempt assets would bear none of the depreciation attributed to indebtedness and the tax base would be comparatively small. Hence, in order to arrive at a fair evaluation of the total taxable capital stock, a formula was adopted.[25] This formula involved three steps: first, an evaluation of the total capital stock—apparently merely an addition of all assets, tangible and intangible, including good will; secondly, a scaling down of this figure by "taking into consideration the indebtedness"; and thirdly, this figure was reduced to the extent of the proportion that the exempt assets bear to the total assets. The result of this formula: $\frac{\text{taxable assets}}{\text{total assets}}$ X value of capital stock—is that the exempt assets are subtracted at their reduced value.

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21. *Supra* note 6.

22. PA. STAT. ANN. (Purdon, Supp. 1939) tit. 72, § 1894.

23. It was originally held that if the domestic corporation owned substantially all of the stock in a foreign corporation, that amount of the stock was exempt which represented foreign assets. Commonwealth v. Westinghouse Air Brake Co., 251 Pa. 12, 95 Atl. 807 (1915). But this holding was overruled in Commonwealth v. Sunbury Converting Works, 286 Pa. 545, 134 Atl. 438 (1926). This section was enacted to reinstate the *Westinghouse* ruling.

24. *Supra* note 5.

25. PA. STAT. ANN. (Purdon, Supp. 1939) tit. 72, § 1896. This is the formula adopted by the trial court in Commonwealth v. Pennsylvania R. R., 31 Dauph. 13 (1927), *reversed*, 297 Pa. 308, 147 Atl. 242 (1929). The section was adopted in 1931 and reinstate's the trial court's holding.

The Effect of the Capital Stock Tax

The result of this scheme of taxation and the interpretation of the statute by the courts was highly unsatisfactory from the point of view of the Commonwealth. Whereas the tax reached the value of practically all tangible property in Pennsylvania owned by domestic corporations and almost all the intangible value, it completely failed to reach any of the intangible worth of the foreign corporations.[26] The idea, of course, had been to reach the value of the business in Pennsylvania—a value admittedly within Pennsylvania's taxing jurisdiction. This value naturally included some intangible value. Under the Federal Constitution there appear to be only two methods by which to reach these intangibles. One is by the "commercial domicile" or "business situs" theories mentioned above; the other, by the "unitary" or "going concern" theory of valuation of property in the state. Under this latter theory, the property in the state is considered as having increased value because it is part of a large going concern.[27] The amount of the *increase* is that proportion of the total intangible property which the tangible property in the state bears to the total tangible property. Although this theory seems to be in direct violation of the rule that intangibles follow the person for tax purposes, it was early sanctioned by the Supreme Court of the United States.[28] But the capital stock tax failed to provide any such method of evaluation. Consequently, the rule of *mobilia sequuntur personam* was applied in all its rigidity.

The terms of the statute, when applied in the light of the Constitution, resulted in discrimination against *domestic* corporations; yet it seems never to have been contended that the discrimination was unconstitutional.

The economics of the situation led the legislature to amend the statute in an attempt to iron out the discrimination and fill the Commonwealth's coffers.

The Franchise Tax

The 1935 amendment to the capital stock tax imposed on foreign corporations a franchise tax as a substitute for the tax on the capital stock.[29] The purpose of the amendment was to reach intangible values in foreign corporations. The franchise tax is one on the privilege of doing business in Pennsylvania, measured by the value of that business[30] and levied at the rate of five mills. In order to arrive at a tax base—called a "taxable value" in the statute—the total value of the corporation is computed. This value is considered as having a direct relation to the value of the franchise to do business in Pennsylvania and the proportionate worth is found by comparing the tangible property, payroll, and gross receipts respectively located in, paid in, and derived from Pennsylvania with the total tangible property, payroll, and gross receipts.[31] Nowhere in this procedure does the statute provide for any exemptions in finally computing the taxable value. This scheme of taxation is merely an application of the "going concern" or "unitary" principle expounded above except that this time it is applied to a privilege instead of property. It has the same effect

26. Commonwealth v. Curtis Publishing Co., 237 Pa. 333, 85 Atl. 360 (1912).
27. Adams Express Co. v. Ohio, 165 U. S. 194 (1897). See an illuminating discussion of this evaluation theory in Powell, *Indirect Encroachment on Federal Authority by the Taxing Powers of the States* (1919) 32 HARV. L. REV. 234.
28. *Adams Express* case, *supra* note 27.
29. PA. STAT. ANN. (Purdon, Supp. 1939) tit. 72, § 1871.
30. Commonwealth v. Columbia Gas & Elec. Co., 336 Pa. 206, 8 A. (2d) 404 (1939), 88 U. OF PA. L. REV. 232.
31. *Supra* note 29.

of subjecting "foreign" intangibles to taxation. How much of this intangible worth is thus ingeniously reached depends, of course, on the allocation formula.

Suppose both Massachusetts and Texas levied a franchise tax on a Delaware corporation manufacturing oil drills in Massachusetts and selling them in Texas. If the allocation factor in Massachusetts were gross sales in Massachusetts compared to total gross sales and the factor in Texas were tangible property in Texas as compared with total tangible property, neither state would tap the intangible resources of the corporation. And conversely, if Massachusetts used the property factor and Texas the sales factor, each state would tax practically the total intangible value. On the other hand, if both states used both factors, the intangible tax pie would be evenly divided between them.[32] Thus it appears that the more items, having relation to a corporation's value, used in the allocating fractions, the more equitable the distribution of intangibles among the taxing states. But equitable distribution has never been a constitutional *sine qua non* in regard to the taxation of intangibles by a franchise tax. Multi-state burden is no objection.[33] All that is required is that the allocation factor have some reasonable relation to the value of the corporate franchise and the Pennsylvania system adequately meets this requirement.[34]

Admitting then, that, in the abstract, the state has jurisdiction to tax foreign corporations according to the present law, the question still remains whether, taking the system as a whole, the legislature has not overreached and violated either the equal protection clause of the Federal Constitution[35] or the uniformity clause of the Pennsylvania Constitution,[36] or both.

It has often been said that a foreign corporation, when admitted to do business in a state, is entitled to the equal protection of the laws.[37] This means that it may not be subjected to penalties or burdens not imposed on others within the same classification. At the same time, it has been said that foreign corporations may be treated differently for the purposes of taxation.[38] Thus we have two apparently contradictory theories. Reconciliation is reached through compromise. Whereas it is permissible to tax foreign corporations under a different theory and by a different tax, the net result must be that the burden is not materially different.[39]

32. Delaware's admitted right to tax the total intangible property is due to the rule that a corporation's domicile is the state of incorporation and since intangibles follow the person for tax purposes, all the intangibles are in Delaware. Cream of Wheat Co. v. Grand Forks County, 253 U. S. 325 (1920). The survival of this fiction is responsible for a great deal of the current tax inequality and stands in the way of a satisfactory solution of the multi-state taxation problem.

33. First Bank Corp. v. Minnesota, 301 U. S. 234 (1937). For discussion of multiple burden on intangibles in other fields of taxation see (1939) 88 U. of Pa. L. Rev. 120. For the question of multiple burden in regard to the Commerce Clause see Note (1939) 87 U. of Pa. L. Rev. 712.

34. Commonwealth v. Columbia Gas & Elec. Co., 237 Pa. 206, 8 A. (2d) 404 (1939), 88 U. of Pa. L. Rev. 232.

35. U. S. Const. Amend. XIV, § 2.

36. Pa. Const. Art. IX, § 1.

37. Southern Ry. v. Green, 216 U. S. 400 (1910); Hanover Ins. Co. v. Harding, 272 U. S. 494 (1926); Northwestern National Ins. Co. v. Lee, 49 F. (2d) 274 (D. Ore. 1931); *cf.* National Savings & Trust Ass'n v. Gillis, 35 F. (2d) 386 (D. Idaho, 1929).

38. Cheney Bros. Co. v. Massachusetts, 246 U. S. 147 (1918); Northwestern Mutual Life Ins. Co. v. Wisconsin, 247 U. S. 132 (1918); Southern Realty Corp. v. McCallum, 1 F. Supp. 614 (W. D. Tex. 1932).

39. Concordia Ins. Co. v. Illinois, 292 U. S. 535 (1934). "Mathematical equivalence is neither required nor attainable, nor is identity in mere modes of taxation of importance where there is substantial equality in the resulting burdens." *Id.* at 547.

The problem is whether the franchise tax imposes a burden "equal" to that imposed by the capital stock tax on domestic corporations. In this connection the term "equal" must be rather carefully defined. Equality does not mean that domestic corporations and foreign corporations of equal total net worth pay an "equal" tax. For Pennsylvania has jurisdiction to tax only that part of the value of a corporation which can be legally assigned to Pennsylvania. Before an economic comparison can be made for the purpose of determining whether the legislature has discriminated, the amount which the state has *power* to tax under the Constitution must be ascertained.

For purposes of taxation it has been shown that certain intangibles of foreign corporations are without the jurisdiction of the taxing state. Theoretically its tangible property located elsewhere is likewise immune because it is often said that under no guise may a state reach property outside its borders. But this overlooks the effect of the "going concern" theory of valuation. If a large proportion of a corporation's holdings outside the state is tangible property and the "going concern" valuation is applied to values within the state, the amount of increase over the intrinsic worth of local assets must be largely derived from the foreign tangible property.[40] The result is that the amount over which the state has jurisdiction to tax will vary according to its method of evaluating assets within its borders. Thus, in addition to comparing results of the different taxing schemes when applied to equal values over which Pennsylvania has jurisdiction, it is important to notice on what theory that jurisdiction was gained in each case.

For the purpose of this investigation it is immaterial that the tax is on the franchise in the one case and on property in the other. It is the result which matters and not the theory. If, in fact, the use of the different theory or form of taxing foreign corporations imposes on them a greater burden, the equal protection clause does the rest.

Before advancing to the comparison, it is well to bear in mind that certain rules and methods of ascertaining both taxes spring, not from the statute, but from decisions of courts and administrative rulings. Consequently, if the statutes can be administered so as to impose an equal burden, it is not necessary that the statute itself expressly prescribe this equality.[41]

A Hypothetical Case

Suppose two corporations. One is organized under the laws of Pennsylvania and the other under the laws of Delaware. Both are doing a manufacturing business in Pennsylvania and have a small annex plant in New

40. In Wallace v. Hines, 253 U. S. 66 (1920), and in Hans Rees' Sons v. North Carolina, 283 U. S. 123 (1931), tax assessments were invalidated because, as to those corporations complaining, the local allocation formula had resulted in allocating to the taxing state an excessive value. *But see* Ford Motor Co. v. Clark, 100 F. (2d) 515 (C. C. A. 5th, 1938), *aff'd*, Ford Motor Co. v. Beauchamp, 60 Sup. Ct. 273 (1939). In that case a gross receipts formula succeeded in allocating to Texas, for franchise tax purposes, a business value of $23,000,000 when the value of assets, including some intangibles, in Texas was only $3,000,000. Since the fraction was applied to the whole capital worth of the corporation a certain percentage of its vast plant in Detroit was necessarily included. It was argued, citing the *Hans Rees* case, that the formula produced "absurd results". In disposing of this contention the circuit court said that the *Hans Rees* case was irrelevant and added: "If it be practicable to separate the manufacturing from selling activities, this petition affords no data to do it." *Id.* at 517. The Supreme Court did not attempt to distinguish between allocating intangibles and allocating value derived from foreign tangibles. Nor was any mention made of the *Hans Rees* case. Was it overruled *sub silentio?*

41. Hanover Ins. Co. v. Harding, 327 Ill. 590, 158 N. E. 849 (1927).

Jersey. Both employ a large sales force operating on a national scale. Each owns tax-free United States bonds. Each owns stock in a Pennsylvania corporation which is itself subject to the capital stock tax. Each owns stock in foreign corporations. Each owns a majority of the stock in a foreign corporation and this stock represents an equal value of property outside Pennsylvania. Each is capitalized at an equal amount and each is indebted to the same degree and is earning equal dividends. Their balance sheet is identical:

Assets		*Liabilities*	
Pennsylvania plant	$100,000	First mortgage bonds	$ 50,000
New Jersey plant	40,000	Accounts payable	50,000
Tax free bonds	5,000	1,000 shares of capital stock ($100 par value)	100,000
Stock in Pa. corporations	5,000		
Stock in foreign corporations	10,000		$200,000
Stock in foreign corporation equal to a majority of the outstanding voting stock	10,000		
Accounts receivable	10,000		
	$180,000		
Deficit	20,000		
	$200,000		

The first problem here presented is to determine what assets are within Pennsylvania and what value can be attributed to those assets. First the case of the domestic corporation under the capital stock tax as construed by the courts: The value of the New Jersey plant must be deducted. This is done by the formula adopted by the courts and later incorporated in the statute. First the total worth of the assets is found—$180,000. Then the indebtedness is "taken into consideration" thus finding the net worth of the corporation—$80,000. From this figure the *actual* value of the New Jersey plant is deducted. The actual value is found by reducing its intrinsic value in the proportion that all the assets have been reduced by taking the indebtedness into consideration. The reduced value of the New Jersey plant is $17,777.78 which, when deducted from the total actual value of the corporation, leaves within Pennsylvania $62,222.22.

Turning now to the operation of the franchise tax on the foreign corporation, we find a different picture. The capital stock is divided into thirds—$26,666.67—and each third is multiplied by a fraction. The sum of the resulting three products is the value assigned to Pennsylvania.[42]

The first fraction is the tangible property fraction. In this case 10/14ths of the tangible property is in Pennsylvania. 10/14ths of $26,666.67 is $19,047.62.

The second fraction is the wages fraction. Assuming that sales headquarters are in Pennsylvania and that the salesmen report directly to the home office, salesmen's wages are, under the statute,[43] assignable to Pennsylvania. Assuming that wages paid to the employees of the New Jersey plant are 1/3 of the wages paid in the manufacturing part of the

42. PA. STAT. ANN. (Purdon, Supp. 1939) tit. 72, § 1871.

43. *Ibid.*

business and that sales wages are 1/2 of the total wages, then the wage fraction is 5/6ths of $26,666.67, or $22,222.23.

The third fraction is the gross receipts fraction. Assuming that the corporation's salesmen report sales income directly to the home office, all gross receipts are assignable to Pennsylvania.[44] Consequently the fraction in this case is 1 and the full value of the last one-third part of the capital stock is allocated to Pennsylvania.

The sum of these three products is $67,936.52. Compare this with the sum of $62,222.22 assigned to Pennsylvania under the capital stock tax.

Apart from the question of intangible value thus neatly allocated to Pennsylvania, it is evident that the operation of the franchise statute succeeds in assigning to the state a value of $5,714.32 which can be attributed only to the New Jersey real estate. This would be the result in every case in which the value of the tangible property is more than one-third of the total worth of the corporation for the other two fractions in the formula will surely operate so as to allocate some of the foreign property value to Pennsylvania. Thus it would be hard to maintain that this was merely a fortuitous inequality peculiar to the hypothetical situation.

This initial inequality stems from a different method of evaluation. In the case of the domestic corporation the worth of the corporation is found by mere addition of the actual value of the individual items. In the case of the foreign corporation, the "going concern" method is used. It is true that the statute nowhere specifically provides for this result but it is inherent in the different forms used. The capital stock tax gives complete exemption for foreign property—the franchise tax only partial exemption. It appears to the writer that this discrepancy, admittedly a lurking one, comes within the prohibition of both the uniformity and equal protection clauses.

But if the same deduction may be allowed the foreign corporations by judicial "construction" of the act, then the discrimination will, of course, be dissipated and the system upheld. It is difficult to see on what principle it could be allowed. It cannot be successfully maintained that the deduction must be given because the tax is, in effect, a tax on foreign property as was done in the case of the capital stock tax. The purpose of changing the form of the law was expressly to obviate this objection to taxing the resources of foreign corporations. This the change has done. The tax is not on property. It is on the privilege of doing business measured by the value of that business in Pennsylvania. Intrinsically the levy is unimpeachable. Its only flaw appears when it is viewed in relation to the capital stock tax. At that point discrimination is seen. The only way presented to allow the deduction is by reasoning that the legislature could not have meant to be unconstitutionally discriminating and hence must have meant the franchise tax to be so administered as not to place a burden on values not touched by the capital stock tax.[45] But the whole purpose of the franchise tax was to reach the going concern value of the business and this value is derived as much from foreign tangibles as "foreign" intangibles.[46] That the legislature *intended* to exempt the foreign tangibles is not probable under the circumstances. Besides, in order to reach the desired result,

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44. *Ibid.*

45. *See* Commonwealth v. Columbia Gas & Elec. Co., 237 Pa. 206, 8 A. (2d) 404 (1939), 88 U. of Pa. L. Rev. 232, where the court found no difficulty in directing tax officials to exclude from their calculation of the tax the value of the taxpayer's business which had no relation to the business done in Pennsylvania.

46. Atlantic & Pacific Tea Co. v. Grosjean, 301 U. S. 412 (1937); Ford Motor Co. v. Beauchamp, 60 Sup. Ct. 273 (1939).

the court would have to change the wording of the statute which provides that the allocation formula shall be applied to the *whole* capital stock.

EXEMPTION OF UNITED STATES BONDS

In the case of the domestic corporation, the actual value of these bonds must also be deducted. Their actual value, found by applying the same calculation as in the case of foreign tangible property, is $2,222.22. When this figure is deducted from the $62,222.22 assigned to Pennsylvania, a $60,000 taxable balance is left.

There is no deduction allowed the foreign corporation by the statute. Once more, however, it may be that the courts may construe the deduction into the franchise tax. It will be remembered that the necessity for exempting the bonds in assessing the capital stock tax arose from the constitutional prohibition of laying a direct tax on them. Since the capital stock tax was a property tax which can be neither measured by nor levied on non-taxables, the exemption followed. It is, of course, true that the bonds could be used in the calculation of a franchise tax if the state chose to tax domestic corporations in this way.[47] This is exactly what was done in the case of foreign corporations and, standing by itself, it would be perfectly valid. Again, however, it is the system as a whole which must stand the constitutional test. In the case given, the effect of the system is to tax the foreign corporation on a base $2,222.22 larger than that assessed against domestic corporation.

It may be argued that the inequality is forced on the state by the requirements of the Constitution and not through any discriminatory action on the part of the legislature. Will the Constitution strike down a law which is discriminatory in results because of the Constitution? But the Constitution does not forbid the state to reach the value of the bonds. It merely prohibits direct taxation. It seems a bit incongruous for the state to maintain that it cannot tax the bonds in the hands of domestic corporations and at the same time tax a value derived from the bonds in the hands of foreign corporations. It seems more logical to say that the legislature has preferred to absolve the domestic corporation—granted an exemption. It has done this just as effectively by choosing a property tax as if it had specifically exempted this item in the calculation of a franchise tax. In order to equalize the burden it would seem that the exemption should be granted to the foreign corporation.[48] But again, on what principle can the exemption be allowed? The amount allocated to Pennsylvania by the formula does not represent any specific property which can be said to be totally within the state for taxing (or exempting) purposes. It is rather an abstraction, a figure representing a proportion of all assets, or, as the statute calls it, a "taxable value". In no case has an exemption been allowed in computing a franchise tax by reason of the fact that some of the assets of the corporation were tax free.[49]

Thus once more the only grounds for judicially allowing the deduction would be that the legislature didn't intend to be discriminatory—an assumption belied by the very terms of the statute and its necessary effect.

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47. Home Ins. Co. v. New York, 134 U. S. 594 (1889); Pacific Co. v. Johnson, 285 U. S. 480 (1932); Manufacturer's Ins. Co. v. Loud, 99 Mass. 146 (1868).

48. *But* see Cheney Bros. Co. v. Massachusetts, 246 U. S. 147, 157 (1917): ". . . a State does not surrender or abridge its power to change and revise its taxing system and tax rates by merely licensing or permitting a foreign corporation to engage in local business".

49. See notes 46 and 47 *supra*.

EXEMPTION OF STOCK IN OTHER DOMESTIC CORPORATIONS AND CERTAIN FOREIGN CORPORATIONS

The same reasoning applies to the exemption allowed domestic corporations on stock in other domestic corporations already subjected to the capital stock tax. In this case, however, there is no constitutional prohibition requiring this value to be exempted from the capital stock tax. Pennsylvania has power to tax it but is judicially presumed not to have so intended.[50] Will the same presumption be applied to the franchise tax? It is impossible to argue in this case that the franchise tax imposes a levy on the same subject as the capital stock tax—that the held stock would be taxed twice. The legislature went out of its way to make the tax on foreign corporations an *excise* tax. How can an excise tax levy on the same subject as a *property* tax. Nevertheless, as in the case of the capital stock tax, a double *burden* is imposed.[51] Aside from the question of finding a legalistic reason for giving the exemption, the problem is whether the legislature intended it to be given. For reasons given below in discussing the method of deducting any exemptions which might be given, it is submitted that the legislature did not so intend.

The last exemption accorded domestic corporations is the value of stock in foreign corporations if the domestic corporations owns a majority of the voting stock. This exemption is purely statutory and is based on nothing more than a spirit of self-denial on the part of the legislature. It did not feel so charitable toward the foreign corporation. Here is an item which the franchise tax was designed to tap—intangibles held by foreign corporations. The courts could grant an equal exemption to foreign corporations only by adding to the statute what was intentionally left out.

Deducting these last exemptions at their actual value from the $60,000 value left after deducting the United States bonds leaves a taxable balance of $53,333.33. Applying the five mill rate, we find that the amount of the capital stock tax on the domestic corporation is $266.67. No deductions being allowed the foreign corporation, the five mill rate is applied to the value originally allocated by the statutory formula—$67,936.52—and the amount of the franchise tax is $339.68.

But even supposing that all the above exemptions could be read into the law, there remains the difficulty of determining to what extent the exempt assets are to be deducted. It must be remembered that each asset is already exempted to a certain extent by the allocation formula. All assets are lumped together and a proportion of their aggregate, reduced by taking into consideration the indebtedness, is abandoned. By this method some assets admittedly taxable by Pennsylvania in their entirety are only taxed proportionally while others admittedly not taxable by Pennsylvania are also taxed proportionally.

In an extraordinary case, of course, the amount that the assets within the state are abandoned by the formula might exactly equal the deduction allowed under the capital stock tax. In such a case the result would be non-discriminatory. But that such a situation should arise is highly improbable and it would be drastic indeed to uphold a statute on the grounds that it might in its operation, by remote possibility, be constitutional.

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50. See note 17 *supra*.

51. *But see In re* Arrott's Estate, 322 Pa. 367, 372, 185 Atl. 697, 699 (1936), where an exemption was allowed under the personal property tax. PA. STAT. ANN. (Purdon, Supp. 7939) tit. 72, § 3242 *et seq.*, on the grounds of double taxation in that the franchise tax was substantially a tax on the capital stock.

The only way, then, to include the exemptions in the franchise tax would be to deduct these items from the value of the capital stock before the allocation formula is applied. The figure representing the value of the capital stock in the formula would then be made up of non-exempt intangibles and tangible property within Pennsylvania. When the allocation formula is applied to this figure—$53,333.33—the resulting tax base is $45,291.00. Of this latter figure $37,742.50 would represent tangible property. Since the "actual" value of the Pennsylvania plant is $44,444.44 it is evident that this system would mean abandoning $6,701.94 of this admittedly taxable value without any corresponding "increase" from foreign tangibles. That the legislature intended to release part of the taxable value within Pennsylvania is hardly to be supposed.

Nevertheless, if such a procedure were followed the resulting tax would amount to $226.45. Comparing this with the $266.67 assessment against the domestic corporation, we find that substantial equality is achieved. The discrepancy is attributable to $1,340.39 worth of intangible value which could not be reasonably attributed to Pennsylvania and $6,701.94 abandoned by the improvident form of the allocating formula when applied to the depleted "capital stock value" as explained above.

While it is possible thus to "construe" the law to make it conform to the constitution, it cannot be done without, in effect, changing not only the existing wording but also the purpose and spirit of the law as it stands. To write four exemptions into the act without any reason therefor but to make results conform to those arrived at under the capital stock tax and then to devise a method of deducting these exemptions would not be worthy of the term "construction". That these things must be done, however, before the taxing system will conform to the constitutional requirement of equality and uniformity seems plain. The act as it stands is distinctly discriminatory. It is suggested that it is for the legislature and not the courts to enact the needed reform.

A. P.

Attorney-Client Privilege as Applied to Documentary Evidence Originating With Client's Agent

It is an accepted rule that the common law immunity from disclosure which is accorded to confidential communications between an attorney and client, arising out of that relationship and pertaining to the subject matter of professional employment,[1] applies not only to oral expressions, but equally to documents and all other written matter.[2] In many states the rule forbidding disclosure has been enacted into statute, but in no instance has the privilege which existed at common law been curtailed. Rather, the tendency of the more recent enactments has been to extend the rule to

1. Chirac v. Reinicker, 11 Wheat. 280 (U. S. 1826); Liggett v. Glenn, 51 Fed. 381 (C. C. A. 8th, 1892); Parrish v. Gates, 29 Ala. 254 (1856); Lorimer v. Lorimer, 124 Mich. 631, 83 N. W. 609 (1900); Downey v. Owen, 98 App. Div. 411, 90 N. Y. Supp. 280 (4th Dep't 1904); Dickson v. Bills, 144 Wis. 171, 128 N. W. 868 (1910). For general treatments of the entire subject of attorney-client communications, *see* 5 WIGMORE, EVIDENCE (2d ed. 1923) § 2285 *et seq.*; 5 JONES, EVIDENCE (2d ed. 1923) § 2154 *et seq.*; 1 THORNTON, ATTORNEYS AT LAW (1914) § 92 *et seq.*

2. Edison Electric Light Co. v. United States Electric Lighting Co., 44 Fed. 294 (C. C. S. D. N. Y. 1890); Lynde v. Judd, 3 Day 499 (Conn. 1807); Anonymous, 8 Mass. 369 (1811); Nelson v. Becker, 32 Neb. 99, 48 N. W. 962 (1891); Selden v. State, 74 Wis. 271, 42 N. W. 218 (1889).

include confidential employees of an attorney within the privilege.[3] However, its application is always dependent on the circumstances surrounding the creation of the communication, and particularly so with respect to documentary evidence. Two categories have crystallized into which all written or printed matter must be placed before testing its immunity from disclosure. The first and clearest situation concerns the claim of privilege to documents which owe their existence to the very fact of communication, or which have originated primarily for the purpose of such communication. To these the true attorney-client privilege is properly applied; and being the precise situation for which the rule was formulated,[4] it is here that it has had its most consistent application.[5] Contrasted with documents which fall within this category are those which originate for other purposes but have been intrusted to an attorney during the course of communications. If the mere fact of possession by the attorney were sufficient to raise the privilege, any documentary evidence, on the slightest pretext, could be given into an attorney's keeping in confidence in order to avoid an order for discovery or a notice to produce. Accordingly, the rationale for this class of papers is that only when the client has some valid privilege against their production, as for example that they might incriminate him, may the attorney who has the documents assert the privilege, and then it is on behalf of the client.[6] But if the client could have raised no objection, then the attorney must produce when called upon to do so.[7]

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3. For a classification of the twenty-nine statutes in effect and a discussion of their trends, *see* Note (1938) 36 MICH. L. REV. 641, 648.

4. The bases on which the privilege is founded are apparent from the following well-considered quotations: "The object and meaning of the rule is this: that as, by reason of the complexity and difficulty of our law, litigation can only be properly conducted by professional men, it is absolutely necessary that a man, in order to prosecute his rights or to defend himself from an improper claim, should have recourse to the assistance of professional lawyers, and it being so absolutely necessary, it is equally necessary, to use a vulgar phrase, that he should be able to make a clean breast of it to the gentleman whom he consults . . .; that he should be able to place unrestricted and unbounded confidence in the professional agent, and that the communications he so makes to him should be kept secret, unless with his consent (for it is his privilege, and not the privilege of the confidential agent), that he should be enabled properly to conduct his litigation. That is the meaning of the rule." Anderson v. Bank of British Columbia, L. R. 2 Ch. D. 644, 649, 24 W. R. 724, 725 (1876). "The policy of the privilege has been plainly grounded, since the latter part of the 1700s, on subjective considerations. In order to promote freedom of consultation of legal advisers by clients, the apprehension of compelled disclosure by the legal advisers must be removed; and hence the law must prohibit such disclosure except on the client's consent. Such is the modern theory." 5 WIGMORE, EVIDENCE § 2291.

5. The most obvious examples of this type are letters passing between attorney and client. Most courts have applied the rule as including both client's and attorney's letters. *Ex parte* Schneider, 294 S. W. 736, 738 (Mo. App. 1927). See also Ganus v. Tew, 163 Ala. 358, 50 So. 1000 (1909); Hardy v. Martin, 150 Cal. 341, 89 Pac. 111 (1907); Selden v. State, 74 Wis. 271, 42 N. W. 218 (1889). And this, even when the client is a corporation. Sovereign Camp W. O. W. v. Ward, 196 Ala. 327, 71 So. 404 (1916). However, there has been some indication that there is no policy requiring the protection of the attorney's letters to the client. *See* Rylee v. Bank of Statham, 7 Ga. App. 489, 492, 67 S. E. 383, 385 (1910).

6. Lynde v. Judd, 3 Day 499 (Conn. 1807); Anonymous, 8 Mass. 369 (1811); Jackson v. Burtis, 14 Johns. 390 (N. Y. 1817); People v. Minkowitz, 220 N. Y. 399, 115 N. E. 987 (1917); Selden v. State, 74 Wis. 271, 42 N. W. 218 (1889).

7. Andrews v. Ohio & Miss. R. R., 14 Ind. 169 (1860); Jones v. Reilly, 174 N. Y. 97, 66 N. E. 649 (1903); Banker's Money Order Ass'n v. Nachod, 120 App. Div. 732, 105 N. Y. Supp. 773 (1st Dep't 1907); Pearson v. Yoder, 39 Okla. 105, 134 Pac. 421 (1913). *But see* Stokoe v. St. Paul, M. & M. Ry., 40 Minn. 545, 546, 42 N. W. 482 (1889); Dover v. Harrell, 58 Ga. 572, 574 (1877). In the latter case a code provision explains the decision.

AGENT'S COMMUNICATIONS

When the documents originate with the client alone, decisions under the two categories discussed evince a satisfactory degree of consistency; but an examination of the cases involving documents which originate with the client's agent reveals serious doubt as to the state of the law. Not only, as Dean Wigmore points out, are the proper limits of this situation "apparently too intricate to permit of a definite rule which will solve all concrete cases",[8] but these bearings of the privilege have received very little development in the United States.[9] The only basis for extending this public policy exception [10] to cover agent's communications seems to be a realization that the client must be left free to delegate his privilege of confidence [11] or otherwise its intended effect may be nullified. This is obviously true in many cases, as for example, where an illiterate employs an amanuensis to write the confidential letter.[12] However, when agents of a corporation originate the communication the problem becomes more complex. Two typical instances of this type are the cases involving reports to railway officers by company agents, and reports to insurance companies.

In the leading American case involving railway reports, *Davenport v. Pennsylvania R. R.*,[13] the court went far in applying immunity to reports of a freight agent made to the company's main offices concerning the loss of a shipper's goods. When the production of the reports was requested, the company answered that they had been submitted for the purpose of resisting the shipper's claim and raised the defense of privilege. In sustaining the defense, the court said of the reports, "They were in effect made to counsel, for they were made for the use of counsel in resisting this particular claim and were transmitted to the proper officer, that he might deliver them to the attorney to whom the defense of the company might be committed." [14] Clearly, the court considered the documents as communications originating for the purpose of communicating information to an attorney. Thus, they fall within the first category and are privileged from disclosure. However, since they were made before the establishment of any actual attorney-client relationship, the existence of which is considered a prerequisite in any case where the privilege is claimed,[15] they might be construed as independent, pre-existing documents whose admissibility would be governed by the *client's* independent grounds for objection. It would seem that this procedure would afford all the protection that such a client needs in that situation. Furthermore, while the tenor of the court's language would seem to accept the English rule that documents prepared with a bona fide intention of being communicated to an attorney are within

8. 5 WIGMORE, EVIDENCE § 2319A (3).

9. *Id.* at § 2319C.

10. See note 4 *supra*.

11. 5 WIGMORE, EVIDENCE § 2317.

12. State v. Loponio, 85 N. J. L. 357, 88 Atl. 1045 (1913) (this case, ignoring the limitations imposed by third party knowledge, takes the liberal view that the privilege extends to any agent of either attorney or client through whom the communication may be transmitted); see also Long v. Siebrecht, 196 App. Div. 74, 187 N. Y. Supp. 150 (2d Dep't 1921). For a discussion of third party knowledge, which bears a close relationship to this situation, see Note (1938) 36 MICH. L. REV. 641.

13. 166 Pa. 480, 31 Atl. 245 (1895).

14. *Id.* at 486, 31 Atl. at 246.

15. 5 JONES, EVIDENCE (2d ed. 1926) § 2166 and cases therein cited at note 1. See also 1 THORNTON, ATTORNEYS AT LAW (1914) § 101.

the privilege,[16] it has been held by at least one court in this country that to extend the rule to cover documents merely *intended* to be turned over later to an attorney would be against public policy,[17] and would allow the veil of subterfuge often to defeat discovery and disclosure. In view of the fact that the rule is an exception to the general liability to give testimony, and that determinations of intent are at best extremely speculative, the latter holding calling for a more sparing use of the doctrine appears preferable. For example, if a corporation requires *all* of its agents' reports to be submitted "for the use of the legal department if and when litigation arises", should the attorney-client privilege extend to avoid disclosure, even though the documents would not be otherwise privileged? Seemingly it does, for the courts have consistently granted immunity to such documents in the railroad cases,[18] even where they were made pursuant to a standing rule requiring their submission on printed forms to the company's claim agent.[19]

An examination of the few cases involving insurance companies reveals that here the courts have not been so consistent. The earliest of these is a Georgia decision [20] which, without giving reasons, allowed the privilege to letters concerning a claim to be litigated, which passed directly between an adjuster for the insurer and the insurer's attorney. Apparently these documents did originate for the purpose of communicating facts to counsel. Some years later, a Virginia case [21] denied the privilege to an employee's accident report which was made as a matter of routine and sent to the attorneys of the insurance company which indemnified the employer. The court seemed to recognize the report as an independent and pre-existing document in its statement, "Neither do we think it was a privileged communication if sent by the defendant (employer) to Cabell & Cabell (the insurance company attorneys) as *its* attorneys." [22] The distinction between these two cases would seem to lie in the purpose in which the documents had their origin. In sympathy with these results, though for a different reason, is the view set forth by a lower court in New York recently.[23] Although the evidence was clear that the insured's statements were given to the insurer in connection with a claim that was later litigated, the privilege was refused although the report was discovered in the hands of the insurer's legal representative. The court reasoned that the privilege

16. Southwark and Vauxhall Water Co. v. Quick, 3 Q. B. D. 315 (1878), where the rule is stated in brief: "Documents prepared in relation to an intended action, whether at the request of a solicitor or not, and whether ultimately laid before the solicitor or not, are privileged if prepared with a bona fide intention of being laid before him for the purpose of taking his advice; and an inspection of such documents cannot be enforced." The English rule is also the rule in Canada. *See* Thompson v. Maryland Casualty Co., 11 Ont. L. R. 44, 45 (1906).

17. *See* People v. Rittenhouse, 56 Cal. App. 541, 546, 206 Pac. 86, 88 (1922).

18. United States v. Louisville & Nashville R. R., 236 U. S. 318 (1915); Atlantic Coast Line R. R. v. Williams, 21 Ga. App. 453, 94 S. E. 584 (1917); *Ex parte* Schoepf, 74 Ohio St. 1, 77 N. E. 276 (1906); Cully v. Northern Pac. Ry., 35 Wash. 241, 77 Pac. 202 (1904).

19. Atlantic Coast Line R. R. v. Williams, 21 Ga. App. 453, 94 S. E. 584 (1917); *Ex parte* Schoepf, 74 Ohio St. 1, 77 N. E. 276 (1906).

20. The Fire Ass'n of Phila. v. Fleming, 78 Ga. 733, 3 S. E. 420 (1887).

21. Virginia-Carolina Chem. Co. v. Knight, 106 Va. 674, 56 S. E. 725 (1907).

22. *Id.* at 680, 56 S. E. at 727. The report was made out in triplicate, and while the decision might have been based on the fact that subsequent third party knowledge would render the communication non-confidential, the language of the court does not lead to that conclusion.

23. Cote v. Knickerbocker Ice Co., 160 Misc. 658, 290 N. Y. Supp. 483 (Mun. Ct. 1936).

cannot exist, even though the attorney later gains possession of the document, ". . . if at the time of delivery of the statement the relation of attorney and client did not exist between the recipient and the plaintiff." [24] Like the Virginia court, this decision regards the statements as independent and pre-existing documents whose admissibility is to be governed by the client's privileges; but unlike the Virginia court the decision indicates that had the statements clearly been shown to have been made to only the legal representative of the insurance company, the privilege would have applied. However, since the report was that of an individual insured, and not the prepared statement of a corporation agent, perhaps the latter conclusion is properly distinguishable from the earlier holding of the Virginia court.

A radical departure from these decisions appears in two recent cases. An Ohio court in *In Re Klemann* [25] extended the privilege to cover a document in the hands of both insured and insurer's attorney. Here, the insured, in compliance with his contract of insurance, sent a casualty report made out by one of its employees to the insurer, who then communicated it to an attorney (who represented both insured and insurer). The court stated that the document was ". . . brought into being as a communication, not in the ordinary course of . . . (the insured's) business," [26] and therefore privileged, evidently on the ground that it had as its origin the purpose of communicating facts to counsel. In granting immunity as to the insurer the court reasoned that "The report thus required, when furnished, becomes the property of the insurance company, and when the original or copy thereof is transmitted by the insurance company, either directly or through an agent, to its attorney, . . . it constitutes a communication from client to attorney, and as such it is protected as a privileged communication . . . ." [27] It is interesting to note that the court in so holding cites one of the earlier railroad cases as an analogy allowing the privilege to the insurance company.[28] However, not only was the report clearly not intended by the insured as a communication to an attorney, as is at least the professed intent in the railroad cases, but its confidential nature is extremely doubtful in view of the fact that it was first submitted to a third party. And unless the insured is considered as an *agent* of the insurer, it is hard to see why the document was not pre-existing and independent as to the latter. Certainly the insurer had no part in its preparation or expression. Although the opinion takes general cognizance of these distinctions, they are not applied to the facts. Under very similar circumstances, the same result was reached by the California courts in *New York Casualty Co. v. Superior Court,*[29] where the *Klemann* case is cited with approval.

Two recent federal cases [30] reach the opposite conclusion with regard to casualty reports to insurance companies. These are in accord with the

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24. *Id.* at 660, 290 N. Y. Supp. at 485.

25. *In re* Klemann, 132 Ohio St. 187, 5 N. E. (2d) 492 (1936), 108 A. L. R. 510 (1937).

26. *Id.* at 192, 5 N. E. (2d) at 494.

27. *Id.* at 193, 5 N. E. (2d) at 495; and although the court applies the privilege under § 11494 of the General Code of Ohio, that Code merely reiterates the common law rule: "The following persons shall not testify in certain respect: 1. An attorney, concerning a communication made to him by his client in that relation or his advice to his client." *Id.* at 191, 5 N. E. (2d) at 494.

28. *Id.* at 193, 5 N. E. (2d) at 495, citing *Ex parte* Schoepf, 74 Ohio St. 1, 77 N. E. 276 (1906).

29. New York Casualty Co. v. Superior Court, 85 P. (2d) 965 (Cal. App. 1938).

30. Kulich v. Murray *et al.,* 28 F. Supp. 675 (S. D. N. Y. 1939); Bough v. Lee, 29 F. Supp. 498 (S. D. N. Y. 1939). It must be noted here, that while these cases both

earlier decisions and the New York holding. Both opinions, although not closely reasoned on the point, strongly support the contention that such reports, when made in a routine fashion and later submitted to legal representatives, will not be considered within the scope of the attorney-client privilege. In light of the prevalent holdings that the mere relation of insurer and insured raises no privilege as to statements passing between them,[31] the latter federal cases and the earlier holdings seem to be more logical considerations, since in almost every such instance, required reports are not primarily communications to an attorney, but requisites to the business of the corporation. Hence, they logically fall into the second category where the admissibility of independent documents is governed solely by the client's privileges, unaffected by any attorney-client relationship.

CONCLUSION

The obvious confusion which the cases exhibit in their attempts to apply the privilege in situations other than where the document relates to no one but an individual client bears out, only too well, the observation that the proper limits are "apparently too intricate to permit of a definite rule which will solve all concrete cases." If the courts are to abandon the tests of the established categories, will complete discretion be vested in the trial judge, as one writer has suggested, to apply the privilege or not as the subject of inquiry appears "legitimate" to him?[32] If so, it would be well to keep in mind that the inherent nature of such immunity is to suppress evidence and hide the truth.[33] On the other hand, most of the uncertainty could seemingly be eliminated by a more careful classification by the courts as to documents truly originating for the purpose of communicating with counsel, and those which have primarily an independent existence. This, combined with a strict adherence to the requisites of confidence and an existing attorney-client relationship, would seem to limit the scope of the privilege to those situations where public policy requires the fostering of the relationship to the exclusion of the general liability to give testimony. The expression of a contemporary Delaware court that "It may be somewhat doubtful if that privilege, which had its origin in the relation of attorney and client, applies to transactions between two branches of an elaborate corporate structure"[34] illustrates the feeling that the salutary objects sought to be obtained by the rule are perhaps not to be found in applying it to the relationship between a corporation and its legal advisers.

R. J. F.

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arose in New York (and in the latter case the court at pp. 501, 502, cites the case of Jones v. Reilly, 174 N. Y. 97, 66 N. E. 649 (1903) as governing authority) and might be governed by the New York practice as to admissibility, the courts in both cases evidently felt that the evidence would not be admissible even under the broad provisions of Rule 43 (a) of the new Federal Rules of Civil Procedure. There, of three alternatives, federal statute, rules of evidence in equity cases in United States courts, and state practice where the trial is held, the statute or rule which is most favorable to admitting the evidence governs. DYER-SMITH, FEDERAL EXAMINATIONS BEFORE TRIAL (1939) §§ 26, 28.

31. Curtis v. Indemnity Company, 327 Mo. 350, 37 S. W. (2d) 616 (1931); Cote v. Knickerbocker Ice Co., 160 Misc. 658, 290 N. Y. Supp. 483 (Mun. Ct. 1936).

32. Note (1937) 46 YALE L. J. 703.

33. This has been the basis for most criticisms of the rule by lawyers and writers since the time of Jeremy Bentham. See, for example, Seabury's Address (1932) A. B. A. J. 371 (where the application of the privilege to public officials and political organizations is criticized); Whipple, *The Duty of Disclosure* (1922) 56 AM. L. REV. 801; Bentham's vehement attack is quoted at length at 5 WIGMORE, EVIDENCE § 2291.

34. Wise v. Western Union Telegraph Co., 36 Del. 456, 467, 178 Atl. 640, 644 (1936).

Where the Merger of a Chose in Action Into a Judgment Will Not Be Recognized*

The doctrine that a chose in action is merged into a judgment rendered upon it [1] is generally explained by the theory that where one claim is represented by two securities of different degrees, the lower merges into the higher,[2] for the higher, when it is docketed, becomes a matter of record, too solemn to be made the subject of judicial inquiry.[3] The most significant, and probably the only, real difference is that in a suit upon the judgment every question which might have been raised in the original suit, regardless of whether it was in fact put in issue, is conclusively determined,[4] and therefore the judgment forms a complete bar to a subsequent suit between the parties on the same cause.[5] The foundation for this result is the principle, old as Anglo-Saxon jurisprudence,[6] that no one shall be twice vexed for the same cause.[7]

Perhaps the confusion in the cases where the problem of merger has arisen is due somewhat to the rigidity of the earlier courts in clinging to technicalities. They dogmatically asserted that the judgment is of a higher nature than the cause of action without looking behind the judgment to determine upon what it was founded,[8] as they would, for instance, in ascertaining the occasion and purpose of the enactment of a statute. However, strict adherence in all cases does not render the more desirable result, so that the wisdom of the rule has been questioned and its application narrowed. For example, where no statute is involved, should a mortgagee by recovering a judgment on a note secured by a mortgage be barred from later foreclosing on the mortgage? Should the doctrine of merger be applied to destroy the protection of a guaranty fund given to a depositor, after he has reduced his claim for deposit to judgment? Should a preferred creditor in bankruptcy proceedings be deprived of his full claim merely because he has reduced it to a judgment which technically is now a new "debt"? To hold that the chose in action "is drowned in the judgment" [9] would deprive the creditor of various superior rights. The courts, seeing these loopholes in the general doctrine, have laid down the broad exception that the general rule of "merger will not be carried further than the ends of justice require".[10]

* The scope of this Note does not extend to the subject of collateral attack on a judgment obtained by fraud, or in a court without jurisdiction, etc. "Judgment" as used here may be assumed to mean a valid judgment.

1. McGilvray v. United States, 62 Ct. Cl. 533 (1926); Williamsburgh Sav. Bank v. Town of Solon, 136 N. Y. 465, 32 N. E. 1058 (1893); Thomas *et al.* v. First State Bank of Panhandle, 57 S. W. (2d) 262 (Tex. Civ. App. 1933).

2. United States v. Price, 50 U. S. 83 (1850); Runnamaker v. Cordray, 54 Ill. 303 (1870); *accord,* Moore v. Justices of Municipal Court of Boston, 291 Mass. 504, 197 N. E. 487 (1935).

3. Ault v. Zehering, 38 Ind. 429 (1871).

4. Woods v. Locke, 49 Idaho 486, 289 Pac. 610 (1930).

5. Mutual Benefit Life Insurance Co. v. Bachtenkircher, 209 Ind. 106, 198 N. E. 81 (1935), 104 A. L. R. 1141. Obviously a judgment *in rem* would not so merge the cause of action that it could not be prosecuted *in personam.* Wallace v. Armstrong, 236 Ill. App. 457 (1925).

6. Sparry's Case, 5 Co. 61 (1590).

7. Gray v. Richmond Bicycle Co., 167 N. Y. 348, 60 N. E. 663 (1901).

8. Brown v. West, 73 Me. 23 (1881).

9. Biddleson v. Whitel, 1 W. Black 506, 96 Eng. Rep. R. 293 (1750).

10. Byram v. Miner, 47 F. (2d) 112, 119 (C. C. A. 8th, 1931), *cert. denied,* 283 U. S. 854 (1931).

However, the application of this exception has been difficult. What is injustice today may seem perfectly just tomorrow. With this in mind, an endeavor has been made to analyze the cases, and to catalog them according to the various factual situations as they have arisen. It is the primary purpose of this Note to indicate what the courts have done in the past with reference to each particular situation, in the hope that it will aid in determining "what the ends of justice require".

WHERE MERGER WOULD DIVEST THE JUDGMENT CREDITOR OF A SECURITY

The case most frequently litigated is where a mortgagor executes a note, secures it with a mortgage, the mortgagee sues on the note and recovers a judgment; later the mortgagee attempts to foreclose and the mortgagor defends on the ground that the note was merged into the judgment, and since the obligation on the note no longer exists, the security for that obligation no longer exists. However, the courts almost unanimously reject this contention, and the authorities lay down as a general rule that the recovery of a judgment cannot be set up as a defense to an action of foreclosure,[11] in absence of a statute requiring the mortgagee first to proceed against the security.[12] In several jurisdiction, however, it has been held that where a judgment on the note has been obtained, the remedy on such judgment must first be exhausted by execution.[13] How the judgment technically becomes secured by the mortgage is not explained by courts adhering to the majority view. The rationale is that the merger of the note into a judgment does not extinguish the debt,[14] thereby assuming the exception to the doctrine rather than explaining it.

Where the mortgagee forecloses first, but does not obtain a deficiency judgment, and subsequently sues on the note, the courts again come to the conclusion that merger does not apply.[15] Should the debtor reside in a different jurisdiction than the one in which the security is located, the question of merger would not arise, for then the note and mortgage would not be so closely tied together that the creditor must sue on both in the same action.[16] "He may bring an action against the debtor wherever he may be found, but can only foreclose the mortgage in the jurisdiction where the mortgaged land lies." [17]

Where the security is in the form of any other type of lien a few jurisdictions have adhered to the doctrine of merger, concluding that in this situation its application is not so manifestly unjust.[18] So where the lienholder sued on the account giving rise to the obligation, he was precluded in a subsequent action from foreclosing the lien.[19] Obviously with the judgment being on the original debt, i. e., the account, the court was

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11. Boucek v. Pondelicek, 259 Ill. App. 59 (1931); Rossiter v. Merriman, 80 Kan. 739, 104 Pac. 858 (1909), 24 L. R. A. (N. S.) 1095 (1910); Rhomberge v. Bender, 28 S. D. 609, 134 N. W. 805 (1912), 12 COL. L. REV. 468.

12. See 1 WILTSIE, MORTGAGE FORECLOSURES (5th ed. 1939) § 6.

13. Rossiter v. Merriman, 80 Kan. 739, 104 Pac. 858 (1909); Stegeman v. Fraser, 161 Mich. 35, 125 N. W. 769 (1910); Shufelt v. Shufelt, 9 Paige 137 (N. Y. Chan. 1841).

14. 1 WILTSIE, *op. cit. supra* note 10, § 162.

15. *Id.* § 8.

16. Houdek v. Brick, 124 Kan. 77, 257 Pac. 753 (1927).

17. Rossiter v. Merriman, 80 Kan. 739, 743, 104 Pac. 858, 859 (1909).

18. Wycoff v. Epworth Hotel Construction and Real Estate Co., 146 Mo. App. 554, 125 S. W. 550 (1910); Brigel v. Creed, 65 Ohio St. 40, 60 N. E. 991 (1901).

19. Wycoff v. Epworth Hotel Construction and Real Estate Co., 146 Mo. App. 554, 125 S. W. 550 (1910).

influenced by its fear that the first adjudication would not be considered final. These few courts have intimated that once judgment is obtained on the obligation, the remedy should be founded on that judgment, since once docketed, by statute in most states, it becomes a lien on all real property owned by the debtor. This view disregards the possibilities that, subsequently to the former lien and prior to the judgment lien, other lienholders may have come into existence, and to hold the first lien extinguished is to penalize the creditor for his caution. Fortunately, the great majority of courts have held that the judgment is not a bar to the enforcement of the lien; [20] that the question is not one of election with that election being final, but is rather one of cumulative remedies.

Where the lienholder first resorts to his security and later attempts to recover on the original obligation, the law is well settled in allowing the second action. Several jurisdictions, on the other hand, hold the obligation merged, even though a deficiency has resulted.[21] In each instance it was urged that there had been a technical merger and although the result was a hardship to the lienholder, to vex the debtor with several suits is equally a hardship on the latter. However, most courts have refused to apply merger, saying that the remedies to foreclose on the lien and to recover on the obligation are again cumulative.[22] "Otherwise he might be compelled to await the outcome of a sale of the property affected by the lien, contemplating a certain deficiency and, at the same time, the disappearance of the other assets of the debtor." [23] In order to avoid two suits at the same time, New York has passed a statute providing that a lien cannot be foreclosed when a judgment at law has been rendered on the debt, unless an execution has been issued and returned unsatisfied.[24] This apparently solves the problem.

Upon careful examination of the above situations, there would seem to be no social policy requiring merger. On one side is the plaintiff, interested solely in the satisfaction to which he is entitled; on the other, the defendant, with a right not to be harassed by superfluous suits. But certainly the latter cannot complain of them as excessive when full satisfaction is all that is being sought. Since the basis for merger is that the defendant "shall not be twice vexed with the same action", the doctrine should apply only where it promotes the desired end, and not where it deprives the cautious creditor of his security. Such was not the intention of the parties, for they must have anticipated, in actual fact, that the security stipulated for should exist until actual satisfaction of the debt.[25] Moreover, a mortgage or a lien has been considered as a cause of action combined with security which in itself is a cause of action [26] and if the former element is transformed into a judgment, the latter may still remain intact.

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20. Redd Bros. v. Todd, 209 Ala. 56, 95 So. 276 (1923); Bush v. Block, 193 Mo. App. 704, 187 S. W. 153 (1916); Pierce v. Kinney, 152 App. Div. 638, 137 N. Y. Supp. 475 (3d Dep't 1912).

21. Daniels v. Ranyons, 164 Ky. 309, 175 S. W. 338 (1915); Brigel v. Creed, 65 Ohio St. 40, 60 N. E. 991 (1901).

22. Cavalluzzo v. Diamond, 119 Misc. 645, 197 N. Y. Supp. 855 (1st Dep't 1922); Beezley v. City of Astoria, 126 Ore. 177, 269 Pac. 216 (1928); Turner v. Stewart, 51 W. Va. 493, 41 S. E. 924 (1902).

23. Cavalluzzo v. Diamond, 119 Misc. 645, 646, 197 N. Y. Supp. 855 (1st Dep't 1922).

24. N. Y. REAL PROP. LAW § 540.

25. *See* Riley's Adm'r v. McCord's Adm'r, 21 Mo. 285, 287 (1855).

26. Evansville Gas-light Co. v. State, 73 Ind. 219 (1881).

WHERE MERGER WOULD PREJUDICE THE JUDGMENT CREDITOR

Not unlike the situations where merger would deprive the judgment creditor of a security are others where, before judgment, the creditor had special privileges. To hold that merger creates a new debt would deprive the creditor of those privileges. Here several situations are involved:

With the passage of laws exempting certain property from execution of a judgment, the precise question has been frequently litigated. Thus where a debt is contracted prior to the enactment of a statute exempting such property (as homesteads), subsequent to such enactment a judgment is recovered on the debt, and the creditor attempts to assert the judgment as a lien on the exempt property, the vast majority of the courts follow the rule that since the debt was contracted prior to the enactment of the statue, or prior to the acquisition of the property, the property is subject to the execution of the judgment.[27] California, on the other hand, is the only jurisdiction refusing to look back through the judgment,[28] basing its reasoning on the ground that a party taking a homestead should not be required to go back of the record of the judgment and inquire into the date of the contract upon which the judgment was rendered. This reasoning fails to convince, since the records of the court in which the judgment was obtained would have disclosed the fact. The courts agreeing with the majority rule reason that the judgment does not in itself create the debt, but instead it merely recognizes the rights and obligation which were created by the original debt. This broad exception to the doctrine of merger is probably the best illustration of a uniform holding on precisely what "justice requires".

Where the judgment creditor was entitled, under the original contract or chose in action, to certain other privileges, the courts again have made an exception to the general rule of merger. Thus where a depositor, prior to his bank's going into the control of a guaranty fund commission, recovered a judgment on the deposit, it was held that he was still a "depositor" rather than an ordinary creditor and was not deprived of the protection of the guaranty fund given to depositors.[29] Here the Nebraska court laid down the principle that if the creditor was entitled to certain privileges under the original chose he may be entitled thereto after entry of a judgment based thereon. Just how this broad rule will work out cannot be foretold. In applying it, to give the creditor the same privileges that he possessed before judgment should likewise require giving the debtor any corresponding privileges, with the result that the original chose is again being litigated.

Where a judgment is obtained on a sealed instrument, the original demand becomes merged, but the court will look back through the judgment and hold that the Statute of Limitations for sealed instruments applies rather than the shorter limitation.[30] Where the creditor had obtained a judgment before the obligor died, but after the death had entered in probate a claim based on that judgment, it was held that the creditor could still bring a proceeding of *scire facias* to revive the lien of the original judgment, for the court will go behind the allowance of a claim in probate

27. Nowland v. Lanagan, 45 Ark. 108 (1885); Kimball v. Wilson, 59 Iowa 638, 13 N. W. 748 (1882); Gregory Co. v. Cale, 115 Minn. 508, 133 N. W. 75 (1911); Smith's Appeal, 23 Pa. 310 (1854).

28. Fitzell v. Leaky, 72 Cal. 477, 14 Pac. 198 (1887); Simonson v. Burr, 121 Cal. 582, 54 Pac. 87 (1898).

29. State v. Citizens' State Bank of Ralston, 115 Neb. 593, 214 N. W. 6 (1927).

30. Batten v. Lowther, 74 W. Va. 167, 81 S. E. 821 (1914).

(which is a judgment) [31] and consider the nature of the debt.[32] The same principle has been applied to judgments obtained against municipal corporations upon obligations involving a limitation on the fund which might be resorted to or the amount of tax which might be levied for their payment.[33]

In all the above situations to hold that the judgment is a new debt wiping out the old, would undoubtedly work a hardship on the creditor. If satisfaction is his main purpose, rather than an attempt to retry the issues or vex the debtor, strict application of merger would seem unfounded.

Where Merger Would Prejudice Other Creditors

In no class of cases has the technical operation of the doctrine of merger been so frequently limited as in the discharge of a debtor in bankruptcy proceedings. Where a partnership firm was declared bankrupt and, before the adjudication, partnership creditors had reduced their claims to judgments against the individuals one Circuit Court of Appeals held that the judgments did not change the character of the partnership debts.[34] Since, under the equity rule, partnership creditors have first preference over partnership assets and individual creditors first preference over individual assets,[35] to allow the former, merely by obtaining individual judgments, to obtain a preference over other partnership creditors as well as individual creditors, would completely void the rule.

It would seem that whenever any cause of action is to be affected by the discharge, its nature should be reviewed by the court where reduced to judgment. Thus a judgment on a claim which existed prior to the final discharge but subsequently "merged" is cancelled and annulled, for the original chose would have been cancelled; the bankrupt may perpetually enjoin execution on the judgment if application is made within a reasonable time to the court in which the discharge was obtained.[36]

Further, where the plaintiffs recovered a judgment based on a statutory liability for action by a mob, but the funds for such obligations were limited to the amount of taxes which might be levied, the Supreme Court of the United States held that the chose, even though reduced to judgment, was still by nature a claim for tort,[37] and had to be paid from the special levy rather than general funds. It was argued that since the claim was reduced to judgment it was now contractual in nature, and the state statute involving the limitation on the fund was in violation of the constitutional provision "that no state should impair the obligations of contracts". However, this was rejected on the ground that the character of the chose was not changed but that the judgment merely ascertained and established the pecuniary amount of loss. On the other hand, where a judgment was based on a penal statute, it does not abate by the death of the offender although the original claim would not survive the debtor.[38]

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31. Brown v. Darrah, 95 Ind. 86 (1884); McFaul v. Haley, 166 Mo. 56, 65 S. W. 995 (1901).
32. Wolford v. Scarbrough, 224 Mo. App. 137, 21 S. W. (2d) 777 (1929), (1930) 43 Harv. L. Rev. 964.
33. City of Harper v. Daniels, 211 Fed. 57 (C. C. A. 8th, 1914); Smith v. Broderick, 107 Cal. 644, 40 Pac. 1033 (1895).
34. Cutler Hardware Co. v. Hacker, 238 Fed. 146 (C. C. A. 8th, 1916).
35. Epstein & Bros. v. First National Bank, 92 Fla. 796, 110 So. 354 (1926).
36. Boynton v. Ball, 121 U. S. 457 (1887); Cavanaugh v. Fenley, 94 Minn. 505, 103 N. W. 711 (1905).
37. Louisiana v. Mayor, 109 U. S. 285 (1883).
38. Ahearn v. Goble, 90 Colo. 173, 7 P. (2d) 409 (1932).

Again it seems that the prime motive of the courts should be to give satisfaction to the judgment creditor, taking into consideration the interests of all parties involved. Satisfaction should be the controlling factor, much as it is where a judgment in an action of conversion does not destroy the original claim, and the plaintiff may maintain replevin or any other possessory action until full satisfaction is had.[39]

WHERE MERGER WOULD VOID A STATUTORY PREFERENCE

As pointed out previously, the operation of merger has been limited to a great extent in bankruptcy proceedings. Where claims of a particular character are excepted from discharge and they have been reduced to judgment prior to discharge, the question arises whether, by merger, they have become new obligations so as to be cancelled as ordinary debts. In this instance the courts have applied the broad exception, holding that the judgment retains the character of the indebtedness from which it arose.[40]

A decree for alimony is not so merged in a judgment based on it as to make the decree a provable claim in bankruptcy.[41] Had the claim not been reduced to judgment it would have been excepted from discharge and there seems no policy which demands that it be made provable only because it was reduced to judgment. The same is also true where the judgment was based on a liability for fraud, false pretenses or false representations,[42] on a liability for a wilful or malicious injury,[43] or for wages earned ninety days before seizure of the property by the master.[44] But whenever the party relying upon a judgment, in order to enforce it, is obliged to go back of the judgment to the debt on which it is founded and on its face it appears utterly void, the court cannot refuse to take cognizance of that fact.[45]

The question of merger further arises where a possible setoff has been reduced to judgment. Adherence to the strict interpretation of merger would lead to the conclusion that the claim is a new cause of action and consequently could not be set off. However the courts again make an exception and hold that the character of the debt has not been changed. So, where the maker of a promissory note attempted to set off a judgment procured by him against the transferor after the transfer, but on a claim existing at the time of the transfer, the claim giving rise to a judgment was an equity and the transferee who obtained the note after maturity took it subject to that equity.[46] In fact, the general principle is that where the

39. 2 FREEMAN, JUDGMENTS (5th ed. 1925) § 581.

40. Carit v. Williams, 74 Cal. 183, 15 Pac. 751 (1887); Horner v. Spelman, 78 Ill. 206 (1875); Donald v. Kell, 111 Ind. 1, 11 N. E. 782 (1887). *Contra,* Bradford v. Rice, 102 Mass. 472 (1869).

41. Gilchrist v. Cotton, 83 Ind. App. 415, 148 N. E. 435 (1925); Matter of Williams, 208 N. Y. 32, 101 N. E. 853 (1913).

42. *In re* Shepardson, 220 Fed. 186 (D. Vt. 1915); Forsythe v. Vehmeyer, 176 Ill. 359, 52 N. E. 55 (1898), *affirmed,* 177 U. S. 177 (1900); Chambers v. Kirk, 41 Okla. 696, 139 Pac. 986 (1914).

43. Thompson v. Judy, 169 Fed. 553 (C. C. A. 6th, 1909); *In re* Whitney and Kitchen, 146 App. Div. 45, 130 N. Y. Supp. 629 (1st Dep't 1911).

44. *In re* Burton Bros. Manufacturing Co., 134 Fed. 157 (N. D. Iowa, 1905).

45. Brownsville v. Loague, 129 U. S. 493 (1889). This case was followed in Board of Commissioners v. Tome, 153 Fed. 81 (C. C. A. 4th, 1907), involving a judgment against a township on public aid bonds. Because of the form of the judgment and the fact that it had become dormant, application to the court was necessary for its enforcement, and this authorized the court to take notice of the invalidity of the act on which the judgment was based.

46. Gould v. Svendsgaard, 141 Minn. 437, 170 N. W. 595 (1919), 19 COL. L. REV. 157.

defendant wishes to set off against an assignee a judgment secured against the assignor after, but on a claim antedating the assignment, the set-off is permitted.[47]

Since the doctrine of merger is primarily for the purpose of preventing undue litigation, to apply it in the above situations would not effectuate its purpose. Its application should be lenient, and where the claim was coupled with certain privileges as well as conditions, the judgment on that claim should likewise be coupled with those like privileges and conditions.

MERGER OF A JUDGMENT INTO A JUDGMENT

Closely analogous to the broad exception to the doctrine of merger is the question whether a judgment merges into a subsequent judgment in an action to revive the first. In this country, under the "full faith and credit" clause of the Federal Constitution,[48] each state refuses to entertain an action which has been adjudicated in a sister state,[49] except that one state will look behind the judgment of another state if it is based on a penalty or police regulation of another state.[50] The same course is taken where a judgment on a claim valid in one state is contrary to public policy in another state.[51] With respect to foreign judgments they are said not to constitute a merger of the cause of action on which it was based so that a suit cannot be maintained to revive a foreign judgment.[52]

A few courts in the United States hold that a judgment itself is merged when a suit upon it in an action of debt is prosecuted to judgment, reasoning that this carries the doctrine of merger to its logical conclusion; but the cases and writers are most discordant upon this point.[53] In favor of this extension of the doctrine it is argued that the fundamental reason for merger, that there should be an end of litigation, is most applicable here; because it is unjust that a creditor should have several outstanding judgments for a single debt, and should still be able to pile up costs by continuing suits upon the original judgment *ad finitum*.[54] To this contention, it is answered by other courts that the debtor has a simple and effective remedy—he may pay the debt,[55] and for this reasoning, the cogency of which seems quite beyond the need of support, is sought to be fortified by the theory that there is no merger because the judgments are securities of equal degree.[56] The question may most justly be decided by simply balancing two considerations: hardship to the debtor and the necessity of final satisfaction for the creditor.

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47. Gordon v. Decker, 19 Wash. 188, 52 Pac. 856 (1899); *cf.* Littlefield v. Albany County Bank, 97 N. Y. 581 (1885).

48. U. S. CONST. Art. IV, § 1.

49. 3 FREEMAN, JUDGMENTS (5th ed. 1925) § 1394.

50. RESTATEMENT, CONFLICT OF LAWS (1934) § 443.

51. *Id.* § 445.

52. GOODRICH, CONFLICT OF LAWS (2d ed. 1938) § 213.

53. Price v. First National Bank, 62 Kan. 735, 64 Pac. 637 (1901); 2 FREEMAN, JUDGMENTS (5th ed. 1925) § 580. *But cf.* Lilly-Brackett Co. v. Sonnemann, 163 Cal. 632, 126 Pac. 483 (1912); GOODRICH, CONFLICT OF LAWS (2d ed. 1938) § 213.

54. 2 FREEMAN, JUDGMENTS (5th ed. 1925) § 580.

55. *See* Ames v. Hoy, 12 Cal. 11, 19 (1859).

56. If a difference in degree means only that in regard to one security questions may still be raised which in regard to the other are concluded, it is submitted that the judgments are not of equal degree. Conclusive as a judgment may be, still when sued upon in a sister state, questions as to the jurisdiction of the court which rendered it, and as to fraud in its procurement may still be raised. Though there is no authority for the proposition, it seems that the second judgment would set these questions at rest forever.

From this standpoint, that there is no merger seems much the sounder view. There is less reason for applying the doctrine in this class of cases than in that where the original cause is held to be merged into the judgment as discussed above; for there the merger saves the expense and trouble of reopening all the manifold questions which are necessary to an original litigation. The fact that the plaintiff may abuse his remedy by vexatiously prosecuting several suits upon one judgment seems no argument for denying him a remedy when properly used, and in case of abuse it may easily be denied. On the other hand, a creditor seems entitled to as many judgments as he may in good faith procure before satisfaction, for nothing but the flight of the debtor from one jurisdiction to another could make many such suits necessary. Besides, even if the creditor had an outstanding judgment in every state of the union, a satisfaction of one discharges all,[57] and the debtor is not injured except as to costs. Even a more weighty argument in favor of this view is the effect which the doctrine of merger has in altering the position of creditors, for courts which adhere to it are compelled to hold that, with the merger of the first judgment into the second, the lien of the first upon the debtor's property is discharged, and that the creditor, as a reward for his diligence, has his rights postponed to subsequent judgment liens. If these courts look back through the judgment to the date of the first judgment, they are in effect admitting the weakness of their argument that there is a merger.

Conclusion

In light of the loose language of the courts, dogmatic predictions as to what the courts would hold in situations not yet litigated cannot be made and would serve no worthwhile end. But purely on the basis of the questions litigated, the following general conclusions would seem to be indicated:

(1) Where an obligation is secured, suit on either the obligation or security does not so merge the chose into the judgment as to deprive the creditor of his cumulative remedies. The controlling consideration does not involve election of remedies, but rather full satisfaction.

(2) Where to hold the chose merged would deprive the judgment creditor himself of privileges other than security for the claim, the courts will go behind the judgment and consider the nature of the debt.

(3) Where the creditor's claim is of a particular class, he cannot improve his position by prosecuting it to judgment to the detriment of other creditors. The nature of the debt, in effect, has not been changed.

(4) Where merger would deprive the creditor of a preferred claim in bankruptcy proceedings, or of a right to setoff, the courts hold that the judgment retains the character and preference of the indebtedness from which it arose.

(5) Where a suit is brought on a judgment the courts are divided as to whether the former merges into the latter. However the majority and seemingly preferable view is that the judgment is not so merged into the subsequent judgment.

Perhaps more clarity could be given to the question were it not for the loose language of the courts. Where an attempt is being made to retry the issues, the courts have laid down the dogma that the chose is merged into the judgment and no inquiry as to its nature can now be made. Later, when

57. Restatement, Conflict of Laws (1934) § 442.

the same court is confronted with a situation where to adhere to the doctrine would undoubtedly cause hardship as in situations illustrated above, it has found it difficult to avoid the strong language previously set forth.

No one can deny that the merger of a chose in action into a judgment is a fundamental rule of our law. But when "exceptions" to a rule are numerous, it would seem preferable to refer to them as rules of law in themselves, rather than as true exceptions. There is nothing fatal in applying the doctrine of merger for some purposes and not for others. The situations enumerated are of a type where its application would defeat other legal principles, more fundamental than the merger doctrine.

As to questions not yet litigated no dogmatic predictions can be made. However, unless express consideration of the interests of all the parties is given by the courts, no conclusions can be drawn. When precise, rather than loose language, comes to be used then the limitation of the doctrine will be something more than a matter of speculation.

W. E. L.